INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	10
Conclusion	13
Appendix	14

CITATIONS

Cases:	
Lane-Wells Co. v. *Commissioner*, 134 F. 2d 977	12
Simpson, R., Co. v. *Helvering*, 128 F. 2d 742	12
Statutes:	
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 401	14
Sec. 402	14
Sec. 403	10, 15
Miscellaneous:	
Treasury Regulations 101, Art. 403-1	16

548550—43——1

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 248

GENERAL MANAGEMENT CORPORATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 129–144) is reported in 46 B. T. A. 738. The opinion of the Circuit Court of Appeals (R. 158–162) is reported in 135 F. 2d 882.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 24, 1943. (R. 163.) A petition for a rehearing was filed by the taxpayer on June 8, 1943, and was denied by the Circuit Court of Appeals on July 6, 1943. (R. 165, 173.) The

petition for a writ of certiorari was filed on August 9, 1943. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question is whether the taxpayer was taxable as a personal holding company under Section 401 of the Revenue Act of 1938. The answer depends on whether income derived from a contract under which the taxpayer agreed to furnish personal services constituted "personal holding company income" under Section 403 (e) (1) of the Act. This depends in turn on whether the contract designated "the individual who is to perform the services" within the meaning of that section.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The taxpayer, an Illinois corporation, was formed in 1929 for the purpose of financially rehabilitating businesses the credit of which had become impaired, rendering budgetary and accounting services and general corporate financial planning. (R. 129–130.) During 1938, the year in question, the 200 outstanding shares of the corporation were owned by Grant Gillam, 100 shares, S. Margaret Gillam, his sister, 80 shares, and Marguerite Miller, 20 shares. (R. 130.)

Gillam had had wide experience in corporate management and production. Prior to the formation of the taxpayer, he had acted as sales manager of a truck manufacturing company and later became president of the company. Certain banks which were creditors of corporations unable to liquidate loans found that Gillam was successful in arranging repayment of such loans. His services while he was still an employee of the truck company were loaned to other corporations which were indebted to the banks. Gillam was equally successful in liquidating these debts. After solving the financial and management problems of several corporations and in the belief that business could be obtained on the basis of his reputation and experience, Gillam caused the taxpayer to be formed. (R. 130.)

The taxpayer first became active in 1932 and in that year acquired offices in Chicago, Illinois. Gillam immediately made contact with the persons with whom he had done business previously, attempting to obtain for the taxpayer the type of business at which he and his associates had been successful, such as surveys of businesses, accounting reports, monthly analyses, and preparation of budgets. At this time the taxpayer's staff consisted of Gillam, Miller, and A. K. Taber. Miller is an experienced accountant skilled in the preparation of budget projects and had been in charge of the accounting department of the truck corporation of which Gillam had been president. Taber was a qualified cost accountant. (R. 130.)

During the year 1932 the taxpayer made surveys of businesses primarily for the Continental Illinois Bank & Trust Company. In April or May, 1932, the taxpayer, at the request of a bankers' committee representing seven banks, began a preliminary survey of the business and property of United Printers & Publishers, Inc. The bankers' committee instructed the taxpayer to inspect the operating divisions of United with the view of determining whether unsecured debts in the sum of $1,375,000 owed to the banks by United might be reduced 25%. The taxpayer prepared a survey for the banks, made upon the verbal assurance of the bankers' committee that if the survey showed that the business of United might be continued the banks would recommend that taxpayer be placed in charge of handling their interests in United. (R. 130–131.)

In making the survey, Gillam visited all the operating divisions of the company and gathered information concerning possible increase of efficiency in operation, the reduction of expenses, and the amount of capital necessary for the year's operation. Gillam examined the plant and production system of United and made suggestions for more efficient operation. The investigation also showed the necessity of revising United's cost system. From this information Miller, with the assistance of an auditor, prepared the taxpayer's report to the banks. The taxpayer's sur-

vey of United included the projection of the entire year's operations upon a monthly basis. The banks agreed to follow the plans suggested in the taxpayer's survey and taxpayer thereafter made monthly statements of United's business which were compared with the monthly budget submitted in the survey. In addition to the survey of United, the taxpayer made several other surveys in 1932 and submitted accounting reports for other clients. During 1932 the taxpayer had no contract with United. Through 1933 and 1934 the taxpayer continued to supply similar services to United and the banks. (R. 131.)

In 1935 the taxpayer, United and the bank creditors entered into a contract under which United agreed to reduce its outstanding debentures and debts to the banks. Under the contract, United agreed that until the banks were paid in full, it would retain the taxpayer in the same capacity as before, "it being further understood that General Management Corporation will continue to supply to the Company the services of Grant Gillam as Comptroller." For these services "including the services of said Grant Gillam, as Comptroller" the taxpayer would be paid $2,500 per month. It was further provided that if (R. 133)—

> Gillam shall die or shall become incapacitated to such an extent as to make it impossible for him to continue as Comp-

> troller of the Company and General Management Corporation is within three months thereafter unable to supply an individual for Comptroller who is acceptable to the bank Creditors and to the Company, the agreement with General Management Corporation may, at the option of the Company, be terminated when a new Comptroller acceptable to the Bank Creditors has been elected.

The contract in issue here was executed in February 1937. At that time the bank loans were retired, and the taxpayer made its own arrangement with United. By this contract United employed the taxpayer "for services to be rendered by it, as hereinafter more specifically defined (including the services of said Grant Gillam as Comptroller), at the sum of $2,000.00 per month, payable semi-monthly." (R. 134.) The contract then provided as follows (R. 134–135):

> It is understood and agreed that the Company will continue to furnish from data supplied to it by the Corporation or its various divisions, monthly and annual statements, make up yearly budgets projecting the Corporation's operations, use its best efforts to negotiate such loans, as the Corporation may from time to time require in the regular conduct of its business, check all requisitions and study in detail the Corporation's various operating, management and sales problems, and submit such suggestions as it may have for reduc-

ing operating cost and improving the Corporation's profit and financial position The Company will have general supervision over the Corporation's operations to the extent that the Corporation agrees to give the Company full cooperation and to follow recommendations made by the Company promptly and to give them a fair trial. Grant Gillam, as Comptroller, shall continue to supervise the fiscal operations of the Corporation, its divisions and its subsidiaries, and no monies shall be borrowed by the Corporation, its divisions and its subsidiaries, and no payments shall be made to any of the Creditors of the Corporation, its divisions and its subsidiaries without the approval of such Comptroller. The counter signature of such Comptroller or some person or persons designated by him, shall be required on all checks, notes or obligations for the payment of money made or issued by the Corporation, its divisions or any of its subsidiaries. The Corporation, however, reserves the right to pay its entire bank indebtedness at any time.

In the event that the said Grant Gillam shall die or shall become incapacitated to such extent as to make it impossible for him to continue as Comptroller of the Corporation and the Company is within three months thereafter unable to supply an individual for Comptroller who is acceptable to the Corporation, this agreement may, at the option of the Corporation, be terminated.

548550—43——2

The services which the taxpayer performed for United during the year 1938 under this contract were of two types, accounting and financial. The accounting services included a budget projection, analysis of monthly reports received from bookkeepers in the two operating divisions of United, and the consolidation of those figures into monthly reports submitted to it, as well as the preparation of income and miscellaneous tax reports. The financial services consisted of a budget of United's cash requirements for the forthcoming year and the arranging for working capital during the seasonal production period. The taxpayer arranged for all of United's loans and handled the cash receipts and disbursements of that corporation, including the payment of all the bank loans. Copies of the budget prepared by the taxpayer's organization were given to department heads of United for purposes of guidance. (R. 135–136.)

The taxpayer controlled the cash of United. All funds were kept in one account from which nothing could be drawn except over the signature of Gillam, Taber (another employee of the taxpayer), or Miller. No audits of United were made except by taxpayer. The taxpayer's audit reports were accepted by the banks which loaned United money. (R. 136.)

In 1938 the taxpayer maintained a staff of eight individuals, including Gillam, Taber, and Miller.

During 1938 the employees of the taxpayer other than Gillam devoted approximately 75% of their time to the services performed for United. Gillam devoted between 25% and 40% of his time to United in 1938. About 75% of the taxpayer's overhead expenses, or $16,000, was allocated to the services rendered United in 1938. In the year 1938 the taxpayer paid salaries other than to officers in the sum of $6,562. In 1938 Gillam was president of the taxpayer and received a salary of $25,000, Miller was secretary-treasurer of the taxpayer and received a salary of $3,600, and Earl Lowe, vice president of the taxpayer, received a salary of $2,358.94. (R. 136.)

The taxpayer's gross income for the year 1938 consisted of the following (R. 139):

Amounts received or due under United contract dated February 11, 1937	$24,000.00
Amounts received under Magill contract dated June 25, 1934	10,398.42
Amounts received from Consolidated Biscuit Co. as directors' fees	450.00
Interest received	1,091.57
Capital gains on shares of stock	14,931.00
Dividends	6,223.00
Amounts received on final liquidation of Chicago Armored Car Co	3,745.44
Total	$60,839.43

On its income and excess profits tax return for the year 1938, taxpayer reported gross income in the amount of $48,162.31. (R. 139.)

The Board of Tax Appeals held that the amount received by the taxpayer under the United con-

tract constituted personal holding company income derived from a personal service contract as defined by Section 403 (e) (1) of the Revenue Act of 1938. (R. 142.) The inclusion of this amount resulted in a finding that more than 80% of the taxpayer's gross income in 1938 was personal holding company income thereby constituting the taxpayer a personal holding company within the terms of Section 402 and subject to the surtax imposed by Section 401 of the Revenue Act of 1938, and that the taxpayer was liable for the penalty imposed for failure to file a personal holding company return for 1938. (R. 144.) The Circuit Court of Appeals affirmed. (R. 163.)

ARGUMENT

Section 403 (e) (1) includes within the definition of "personal holding company income" amounts received under a contract under which a corporation is to furnish personal services "if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract." That individual must be a holder of over 25% of the corporation's stock. The contract here, by which the taxpayer undertook to furnish the various financial and accounting services specified, expressly provided that Gillam, its

principal stockholder, continue as comptroller to "supervise the fiscal operations of the Corporation, its divisions and its subsidiaries." (R. 134.) If Gillam was unable to continue as comptroller, United retained the option to terminate the agreement.

The Board of Tax Appeals concluded that while the contract provided that the taxpayer furnish monthly statements, prepare budgets, and submit suggestions for improvements of United's profit and financial position, Gillam's individual services were the important ones and that it was for these services that United was entering into the contract. (R. 141–142.) The Circuit Court of Appeals, after pointing out the essentially mechanical character of the taxpayer's functions as compared with Gillam's supervisory duties, concluded that the Board was clearly justified in finding from the evidence that (R. 160–161)—

> discretionary service designated to be performed by Gillam was the inspiring motive for his designation and that the makers of the tools utilized supplied only incidental aid necessary to achievement of the desired purpose,—administrative supervision by Gillam.

Obviously the statute should not be limited in its application to cases where the contracts designate one person to perform himself every item of service contemplated. Both the Board of Tax

Appeals and the court below approached the question as one of determining whether it was the services of the person designated for which United was principally contracting. That is not only a reasonable basis for the application of the statute but any narrower construction might well make the provision ineffectual. Upon this test, there is plainly no ground for questioning the correctness of the conclusion reached on the facts involved.

There is no conflict. There is likewise no occasion for review of the decision because of its possible bearing upon contracts entered into by other personal service corporations. (Pet. 7.) The application of the statute to such companies will depend upon the peculiar facts of each case.

R. Simpson Co. v. *Helvering,* 128 F. 2d 742 (C. C. A. 2d), certiorari granted, June 7, 1943, No. 1, this Term, presents the question whether the penalty provisions of the statute are applicable where a corporation files an ordinary corporate return but not a personal holding company return. See also the Government's petition for certiorari in *Lane-Wells Co.* v. *Commissioner,* 134 F. 2d 977 (C. C. A. 9th), No. 115, October Term, 1943. While the taxpayer here has referred to the *Simpson* case in its Reasons for Granting the Writ (p. 7), it did not challenge the propriety of the penalty (if it is otherwise subject to the tax) either before the Board of Tax Ap-

peals, before the court below, or in the specification of errors in its petition for certiorari.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
SAMUEL H. LEVY,
MURIEL S. PAUL,
Special Assistants to the Attorney General.

AUGUST 1943.